DOW THEORY LETTERS INC.

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THE MARKET: In the last Letter (268) I noted that the advance-decline ratio (following a 17 month "delay") had risen to a new high above its 1963 peak. On top of that, October 9 saw both Averages (in fact all three if we include the D-J Utilities) push to historic highs. The market was providing evidence of broad strength.

Approximately one hour after Letter 268 had gone to press, word was received of Khrushchev's ouster. This was followed in close succession by news of Mr. Jenkin's troubles, Red China's nuclear detonation and Labor's narrow victory in England. If the closing prices of the D-J Averages are any gauge, the market could not have been less concerned. After a sharp intra-day drop on October 15 (actually, Industrials ended that day with a dip of less than 1%), the two Averages promptly resumed their advance, and on October 15 new highs were recorded by Industrials, Rails and the A-D ratio.

Having reached new highs, the market seemed to have "gulped" as it slowly grasped the significance of the events of the past few weeks. A period of irregularity has ensued with Rails pushing to successive new highs and Industrials holding just under their October 20 all-time high of 851.50. As seen on Chart 1, the steady high volume of the past month coupled with the lack of progress in the Industrial Average suggests a certain amount of "churning."

CONCLUSION: New highs were recorded by both Averages on October 20. Dow's Theory is saying that the primary trend of stocks and the economy continues bullish. And although the duration of the advance (28 months) is now excessive if judged by past standards, although average stock yields are now dangerously low by any standards, and although the rate of ascent is hardly spectacular (Industrials are now about 5% above their April-May highs), the Averages have as yet provided no evidence that the advance is over.

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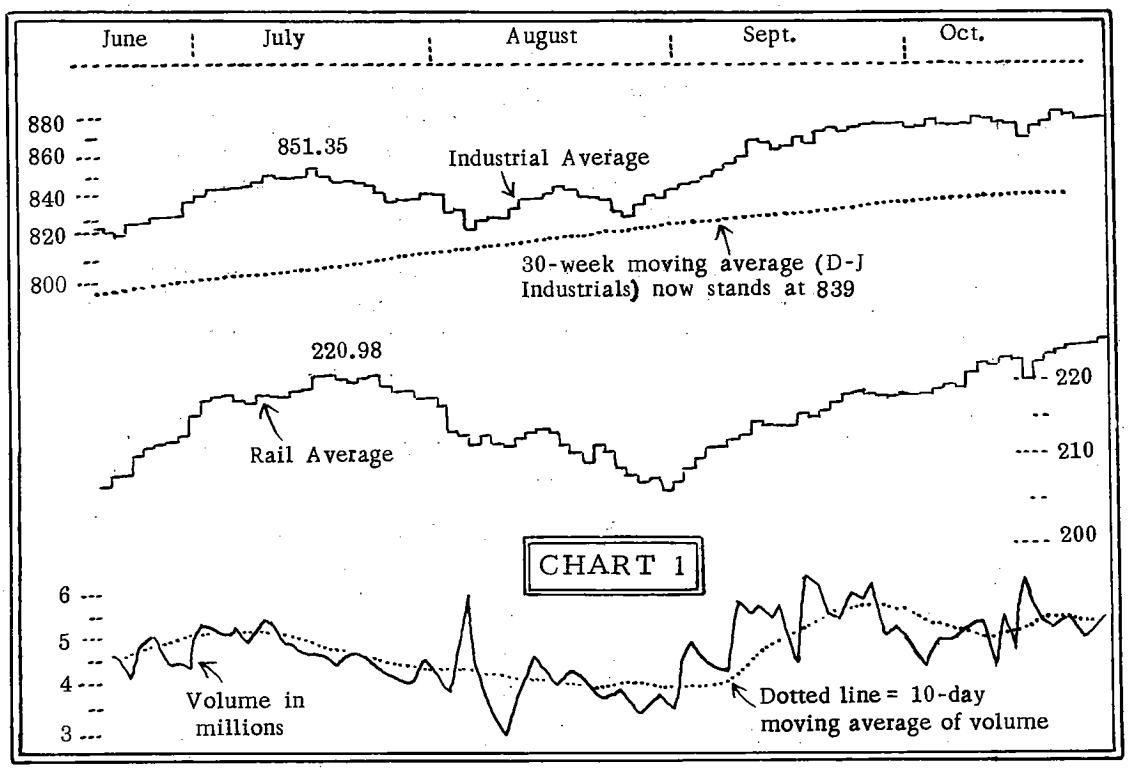
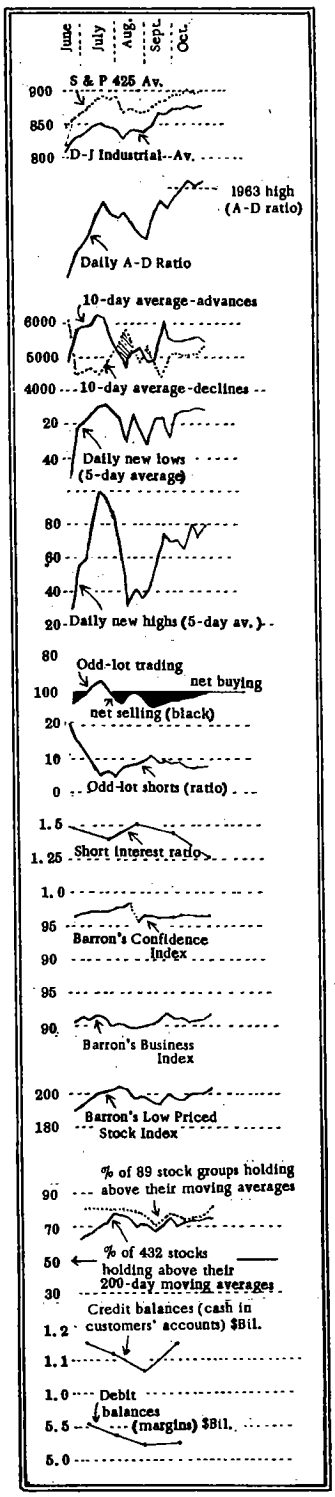
Referring to the composite chart, although the "blue chip" D-J Industrial Average and the broader Standard & Poor 425 Industrial Average are confirming each other in direction, it is apparent that since July, the "425" have failed to match the gains registered by the Dow. A "disparity" in which the "425" lags the Dow often calls for a correction. The implication is that the broad S&P list is





 lagging behind the 30 blue-chip D-J stocks.

The A-D ratio is holding above its 1963 peak, although the 10-day average of advances and declines indicates that buying and selling "pressure" have approached equilibrium. Daily new highs have tended to move higher, but the 5-day average is still below the 99 figure set last July. It is when new highs expand on a week to week and month to month basis that the market becomes really profitable. So far, this has not been the case.

Odd-lot buying and selling are now almost even, but not enough change has been registered here to be significant. Latest short interest ratio figure shows a drop caused by higher average volume (actually the short interest itself rose over 300 thousand). The ratio is in neutral territory. Barron's Confidence Index continues its sideways movement, which suggests no big move ahead for the D-J Industrial Average. Of the 89 Stock Groups shown in the Indicator Chart Service (Palisades Park, N. J.), 76 or 85% are still holding above their moving averages. Of 432 Individual Stocks tabulated here weekly, 326 (75%) are holding above their moving averages. Both studies are still well above the critical 50% level, and are therefore bullish. Credit Balances (cash in customer's accounts) rose $68 million in September but are still well below the January, 1964 high. Debit Balances (margins) also rose $34 million in September but hold far below the peak of November, 1963. Both of these indices appear to have "topped out," a long-term bearish indication.

CONCLUSION: The sum total of these indicators suggest a market which is still bullish on balance, but warning signals (especially in the long-term area) are beginning to show.

PRIMARY TREND: Last week a young subscriber from New York dropped in at this office. He was a broker engaged in some "on-the-spot" research regarding a California retail chain. We discussed the market, and as is often the case, he presented me with a long list of "differences" which set off "yesterday from today." His discourse ended with the statement that since the Government now possesses more power, more agencies, more information and more experience than ever before, he did not see how "they" could possibly allow serious trouble ever to engulf the market again.

This whole line of reasoning is now so wide-spread and so widely accepted that it might be worthwhile to discuss it here again. I have often said that the most fundamental and least-understood of all Dow's original concepts is that of the primary trend. The primary trend is the great irresistible force, the tidal movement which exerts its underlying pressure on all stock prices. When the tide turns up (i.e., a bull market), it presages a period of improving business conditions and "good times" for as long as the bull market is in effect. Robert Rhea often stated that it was impossible to predict the length or duration of a primary movement (and any analyst who has lived through the 1949-64 period fully comprehends the meaning of Rhea's words).

A bull market may continue in force (as this one is doing) regardless of wars, recessions, crises, crashes, assassinations or what have you. It will continue until the best that can be seen ahead is fully discounted in the Averages. When the best finally is discounted, the bull market ends, and the next bear market begins. The ensuing bear market serves to correct the excesses of the preceding bull market. A bear market does not terminate until the worst that can be seen ahead is fully discounted in the price structure. Most bear markets have lasted about 1/3 to 1/2 as long as their preceding bull market; most bear markets have wiped out at least half the gains (in the Averages) of the preceding bull market.

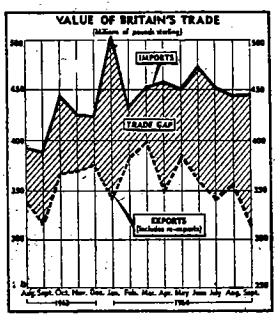
Dow Theorists view a bull market much as they view a man's life. The bull market has stages (phases), comparable to infancy, youth and old age. And every bull market or period of prosperity contains an element of tragedy in it, for within each bull market lie the seeds of decay, disease and finally death. Dow Theorists accept the inevitable death of every bull market much as they accept the inevitable death of every human being. To talk about "the Government not letting a bear market or a depression develop," as far as Dow Theorists are concerned, is tantamount to saying that "a human being need not prepare his will because science is on its way to outmoding death."

Every seasoned investor consciously or unconsciously understands the primary trend concept. This is the reason why bull markets ultimately turn into bear markets. Powerful interests, men who are keen judges of values and conditions, see the writing on the wall and are ultimately willing to swap their stock certificates for cash (regardless of prevailing optimism and rosy business conditions).

Those who believe in the concept of the primary trend know that our politicians have not "manufactured" the current great bull market but rather have been "riding it" for all it is worth. Governments with all their power can heat up a bull market through inflationary policies and deficit spending, but they cannot reverse a bear market.

Thus the late President Hoover (a little known fact) ran up the national debt by one third but failed to put a dent in history's worst bear market. The 1929-32 bear market ended on July 8, 1932, at which time the Averages (Industrials 41.22, Rails 13.23) had discounted the absolute worst that could be seen ahead. I have always been of the opinion that following July 8, 1932, either party could have run a walrus for President and that walrus would have had a better time of it than Mr. Hoover (for a new bull market had already started). Mr. Roosevelt took over a few months after the inception of the new bull market, and the Democrats received credit for the turn to better times. But Robert Rhea had outlined in detail his arguments for buying stocks in July, 1932, while Hoover was still in office. The Averages in July, 1932, had "said" that the worst was over, regardless Hoover, Roosevelt or anyone else.

A few of us who believe in the primary trend concept are wondering what will happen if President Johnson is unlucky enough to be in office when the current bull market terminates. The ensuing bear market could bring about some major changes in Government "planning" and in the Democratic Party economic philosophy. It could also generate a different campaign on the part of the next Republican Presidential aspirant, for he might then be tempted to talk less about defense, immorality and Communism and more about the fundamental issues which really separate the two major parties — issues which this observer always thought were centered around conflicting philosophies of economics, Governmental power, Governmental spending and Governmental intervention.

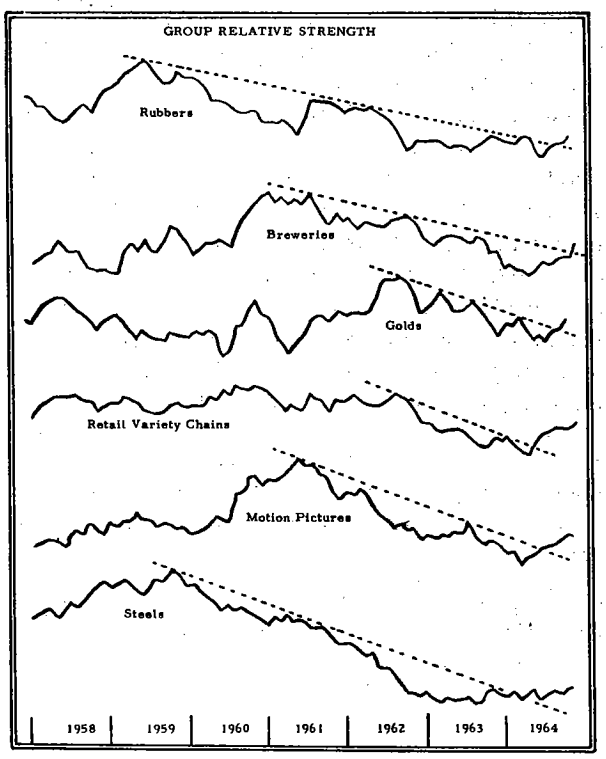


MONEY: The drama of the Anglo-American money markets continues unabated. According to Newsweek (Oct. 26): "It has received only scant attention, but the big U. S. surplus in goods and services, which had been expanding since mid-1963, has recently dropped sharply. In the second quarter, exports topped imports at an annual rate of $7.1 billion, down from $9 billion in the first quarter." But despite the contracting export picture and despite a new round of U. S. wage increases which are bound to further hurt our competitive position, Reserve Board Governor Mitchell last week (was this warning meant for Britain?) cautioned against increasing interest rates at this time.

Meanwhile, Britain's balance-of-payments deficit for September (see little chart which was reproduced from the N. Y. Times) has been announced as a horrendous $372 million — third highest deficit in history. This means that the British deficit will probably approach $1. 7 billion for the full year — an amount equal to about two-thirds of her entire gold and currency reserves! The situation in Britain would ordinarily call for the most prompt and severe measures, with a stiff rise in the discount rate as the number one priority. But since a boost to 6 or 7% in the British rate would (1) put immediate pressure on U. S. interest rates, and (2) slow the British boom, other methods will be resorted to (at least until after the U. S. elections). Today the new Prime Minister, Mr. Wilson, announced export tax incentives and a tax of 15% on all imports (the latter will hurt U. S. exports), and it is hoped that this will "hold the dike" for a while. If the bad news does not "go away" by November or December, the British will undoubtedly be forced to take more fundamental measures.

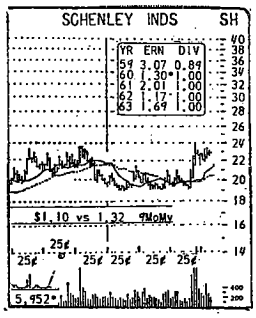
In the light of all this, it is not difficult to understand why DeGaulle barred England from the Common Market. In fact, it has been some time since any of the Common Market partners even asked for a review of the British case.

STOCKS: Relative market performance statistics of all stock groups are maintained at this office. When long-term changes in group popularity (commonly known as relative strength -- R. S.) occur, readers are informed of these changes. Currently, six groups have reversed R. S. declines which have been in effect for three years or longer. As seen on the chart, the Rubber group has turned up after six years of declining market popularity. U. S. Rubber appears to be strongest of the group. The Brewery group is showing an interesting and bullish reversal (could the new low-calorie beer be a factor?). Drewery's Ltd., an important mid-Western brewer, is one that I have been watching. The stock shows a beautiful "double bottom" at 14 (see chart), excellent volume characteristics, and a breakout at 18 1/2. I like it as a speculative commitment.

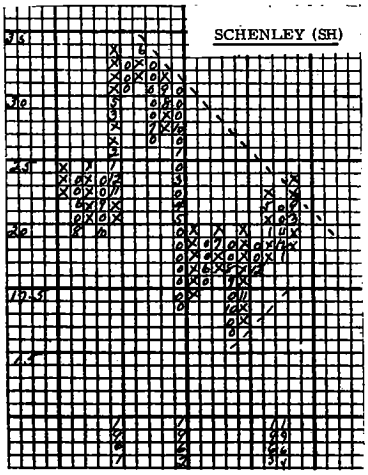


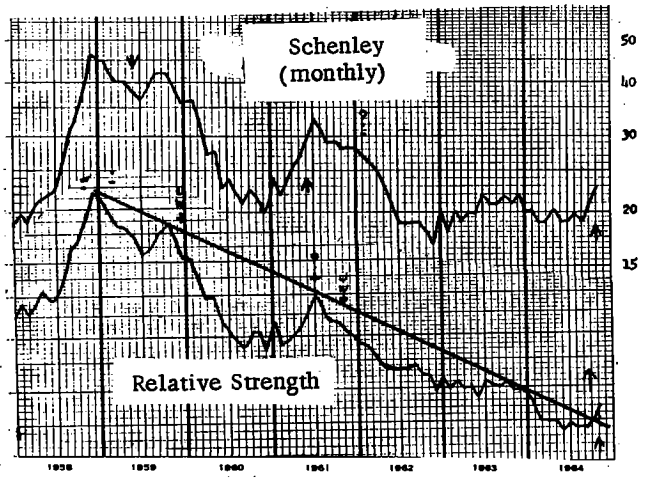
Golds have, of course, been discussed here repeatedly, and I believe they are under continuous accumulation (each year since 1960 the gold average has climbed to a new high, and the average is currently at its high mark for 1964). With Anglo-American inflationary policies progressing as they are, it is little wonder that far-sighted investors are "putting away" golds. I favor American South African and Campbell Red Lake for new commitments, and I note that my Point & Figure friends at Chartcraft now show a "price objective" of 52 for ASA and 21 for CRK. President Brand, a South African gold, was recommended in Letter 268 at 9 1/4. This high-yielding stock sold last week for 10 (quotes are provided daily in the "Foreign Securities" column of the Wall Street Journal), and I rate President Brand as a definite "buy" for all portfolios.

Retail Variety Chains have been mentioned repeatedly (Grant, Newberry, McCrory), and a definite reversal appears to have occurred in this group's R. S. Motion Pictures are turning up following four years of waning popularity. I have recommended MGM as my favorite in this group (Letters 257, 258, 265), and the stock touched a new high last week. I still like MGM, and its

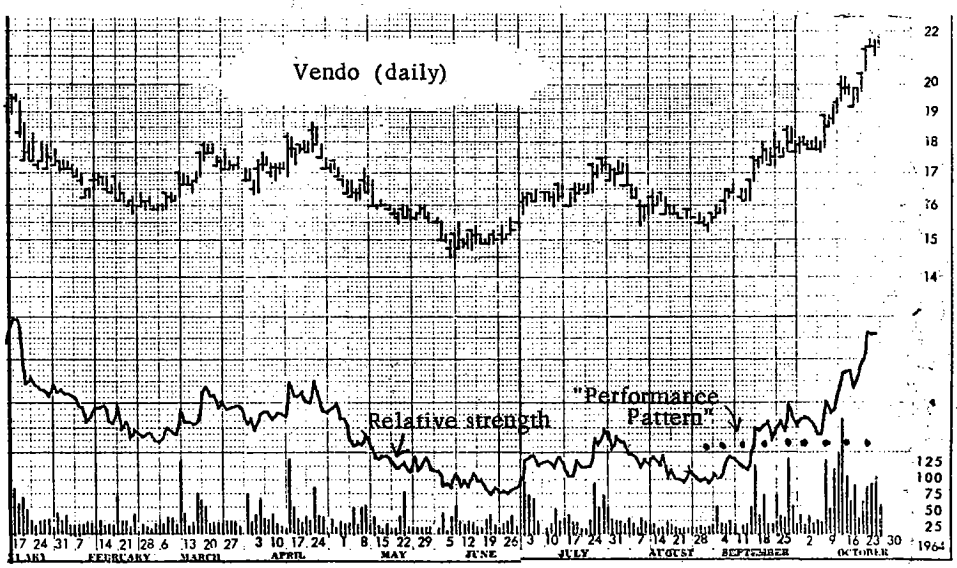


Point&Figure "count shows 51. Steels have reversed a dreary five-year decline in R. S. The "big babies" have shown least action on the rise, and I believe they now offer least downside risk. Of the heavy steel producers, I continue to like Bethlehem best.

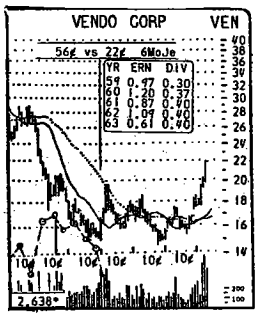


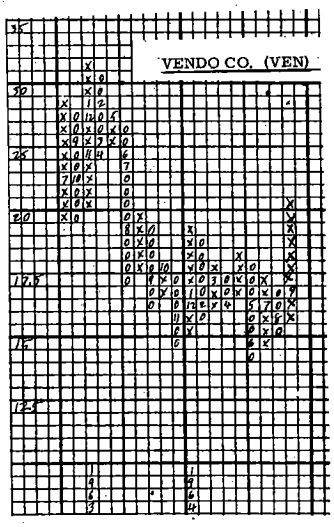


Subscribers continue to write asking for "low to medium priced speculations." In studying the price action, relative strength (R. S.) and history of hundreds of stocks I occasionally do a "double take" as something of particular interest catches my eye. One such "eye-catcher" is Schenley. SH has been a lagger in its group, but as seen on the monthly chart SH has now reversed a six-year downtrend in R. S. The stock is still about 50% under its 1958 high, pays a $1 dividend (yielding 4. 5%) and could now be on its way up. As seen on the point & figure chart, SH reversed its declining price trend at 24, and the P&F "count" on this stock is now 36.



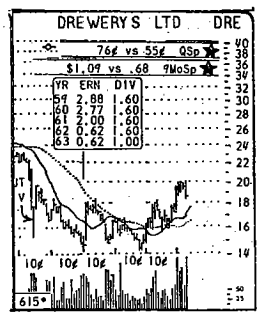
Vendo is another lower-priced speculative possibility. The stock went through a breath-taking collapse from a high of 81 in 1961 to a low of 14 1/2 this year. A halfway retracement would take the stock above 40. As seen on the daily chart, Vendo has come out of a triangle, moving up on expanding volume. The R. S. line is holding above Traders Research's new "performance line" which is a 200-day moving average of R. S. (dotted line). Thus VEN appears to be a good speculation in this area. The stock shows a larger base than either ABC Consolidated or Universal Match (both in the group), and the P&F chart renders a count of 32. After the recent spurt, the odds are that VEN will be in for a "rest" of a few weeks or more. (Note: there has been no fund buying or insider buying in either VEN or SH; therefore, whatever following they have developed must be considered speculative — not institutional).





At the bottom of the page is a weekly chart of Drewery's Ltd. (see page 3). The stock is correcting after the sharp run-up from 16 to 20. The 10-week moving average is now at 17 1/2, and DRE should be a good speculative purchase between 17 1/2 to 18 1/2. Earnings are sharply higher for DRE, and the group is showing important improvement.

LATE NOTE: As this is written (11 A.M. — N.Y. time, Tuesday, Oct. 27), the market is drifting lower and the 10-day averages of advances and declines on the composite chart have crossed. This means that the "pressure" is on the downside — if weakness is to develop, we should see it now.



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Daily chart of VEN courtesy of Traders Research, 1431 Pearl Ave., Alton, Illinois 62003.
Small weekly charts courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas.
P & F charts courtesy of Chartcraft, Larchmont, New York.
Monthly chart of SH courtesy of Ray * Signals, 141 Broadway, New York City 6, New York.